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PUNITIVE PAST TO CURRENT CONVENIENCE — A STUDY OF THE TEXAS LAW OF USURY

by

Ray Pearce* and J. McDonald Williams**

IN HIS classic work, *The Common Law*, the lawyer who was later to become Mr. Justice Holmes commented: "The substance of the law at any given time pretty nearly corresponds, so far as it goes, with what is then understood to be convenient; but its form and machinery, and the degree to which it is able to work out desired results, depend very much upon its past."¹

Mr. Justice Holmes' "general rule" furnishes an appropriate starting place for, and is an aid to the understanding of, the development of the law of usury in Texas.

I. RELIGIOUS AND HISTORICAL ROOTS

The "past," insofar as the law of usury is concerned, consists in part of constitutional and statutory provisions and judicial precedents, but in far greater and more significant part of Judeo-Christian religious doctrine. Several passages in the Old Testament condemn the practice of usury in the strongest terms.² Christian writers, from the first century onward, considered the lending of money "upon usury" to be sinful, and by the time of the Middle Ages, when Christian doctrine dominated the thought patterns of all Western European civilization, the habitual practice of usury was grounds for ex-communication, a penalty which, in those times, amounted not only to a denial of access to the sacraments, but also to a virtual casting out of society.³

Not only was usury considered to be sinful, but the definition of what constituted usury was, by modern standards, extremely broad. Before and during the Middle Ages, it was generally understood that one was guilty of usury if he lent money and required the borrower to repay the principal sum, plus interest or some other additional charge, but did not participate in the risk of the business in which the money was employed. "Risk," for this purpose, did not refer to the risk of not being repaid. The risk necessary in order to avoid the taint of usury was the risk of success or failure of the particular business enterprise. A partnership, or other risk-taking venture, was permissible, even if one partner furnished capital only, and received (if the venture was successful) a return of his capital plus interest on the amount of his investment; but the mere lending of money, in order to "earn" interest on it, was not—and the proscription applied with-

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¹ O. HOLMES, *THE COMMON LAW* 1, 2 (1881).

² *Deuteronomy* 23:19; *Psalms* 15; *Leviticus* 25:36.

³ See generally S. HOMER, *A HISTORY OF INTEREST RATES* (1963); J. NOONAN, *THE SCHOLASTIC ANALYSIS OF USURY* (1957).

out regard to the amount of interest (or other charge) the lender required for the use of his money.

The first major change in the concept of usury occurred during and after the Reformation. Usury was still thought to be sinful, but the definition changed from that of charging any interest (on a "non-risk" loan) to that of charging an excessive amount for the use of the money loaned.

The change of definition had two principal consequences. The first was that, since the receiving of interest was no longer considered to be, in and of itself, improper, there was a slackening of the restrictions against usury; or, to put the same thing another way, an increase in the number of different activities which could be engaged in without running afoul of the prohibitions against usury. The second was a change in the focus of the usury inquiry. As long as the receiving of any interest (or other compensation) for the use of money was considered sinful, the focus of the inquiry was upon the lender—the inquiry being whether the lender was guilty of exacting usury. But after receipt of some income for the use of money was accepted as permissible, the focus tended to shift away from the moral status of the lender, and to the economic or social effect that a particular lending practice had upon what was thought to be the good of society as a whole—that is, the economic or social effect of usury.

Determining what is good for a society as a whole is the task of its lawmakers. It is therefore not surprising that the social regulation of permissible interest rates eventually became embodied in statutory form, first in the Statute of Anne⁴ and then in similar statutes widely adopted in the American states. There has been substantial variation in the legislative notions of how much interest it takes to amount to usury. The issue, from a lawmaking point of view, became and remained one of determining what regulation of interest rates is "convenient" for the cultural community to which the regulation applies.

Convenience has been thought to be served, at some periods of time, by prescribing a maximum interest rate applicable to all loans. At other times, especially in the late nineteenth century under the influence of the Benthamites, the statutes applicable to permissible rates of interest have been repealed in their entirety and the price of money has been left to be determined in the marketplace. Today, when access to credit is considered to be of prime importance, the lawmakers have tended to permit varying rates of interest for various types or sizes of loans.

But the past continues to affect the present. The tendency to think of usury in moral and religious terms has affected the approach and in some instances the decisions of the courts. This is not to say that the courts talk in these terms. They do not. Their decisions most often are based upon the particular wording of constitutional and statutory provisions, and upon the decisions in previous cases. But the language the courts sometimes use, and the decisions they reach, without regard to what they say, reveal the presence of this tendency at work.

⁴ 12 Anne c. 16 (1713).

II. CONSTITUTIONAL AND STATUTORY PROVISIONS

Texas has been more than willing to experiment in its approach to what is "convenient" with respect to usury law. Usury (defined as charging interest in excess of ten per cent per annum) was early prohibited by statute.⁵ Then, in 1869, the legislature repealed the usury laws. Article 12, section 44 of the constitution, adopted in that year, prohibited the legislature from making any further laws limiting the amount of interest that could be collected for the use of money.⁶ Seven years later, in the wake of a flood of credit abuses, the 1876 constitution incorporated a prohibition of interest above twelve per cent per annum;⁷ this limit was lowered in 1891 to the present ten per cent.⁸ The legislature has from time to time augmented the constitutional provisions with additional statutes covering, in the main, the remedies for usury.

The present version of the constitutional provision on usury, as amended in 1960, reads in part as follows:

The Legislature shall have authority to classify loans and lenders, license and regulate lenders, define interest and fix maximum rates of interest; provided, however, in the absence of legislation fixing maximum rates of interest all contracts for a greater rate of interest than ten per centum (10%) per annum shall be deemed usurious; provided, further, that in contracts where no rate of interest is agreed upon, the rate shall not exceed six per centum (6%) per annum.⁹

The 1960 amendment was designed to enable the legislature to classify loans and lenders, so that some loans could bear, though other loans could not, interest at a yearly rate of more than ten per cent. The adoption of this amendment was followed in short order by the enactment of the Texas Regulatory Loan Act,¹⁰ which in turn was recently supplanted and expanded by the Consumer Credit Code.¹¹

Lawmakers are affected, as other citizens are, by the historical view that usury is morally repugnant and criminal in nature. The 1876 constitution, for example, read in part that the legislature shall "provide appropriate pains and penalties to prevent and punish usury."¹² The present-day policy of focusing on the economic consequences of usury, on the other hand, is illustrated in the preface to the Consumer Credit Code, which talks in terms of unregulated credit abuses that "bring great social and economic hardship to many citizens of our State" and "impose intolerable burdens on those segments of our society which can least afford to bear them—the uneducated, the unsophisticated, the poor and the elderly."¹³

⁵ See generally the history recorded in 3 VERNON'S ANN. TEX. CONST. 75 (1955), following TEX. CONST. art. XVI, § 11.

⁶ TEX. CONST. art. XII, § 44 (1869).

⁷ *Id.* art. XII, § 11 (1876).

⁸ *Id.* art. XVI, § 11 (1891).

⁹ *Id.*

¹⁰ TEX. REV. CIV. STAT. ANN. art. 6165b (Supp. 1967).

¹¹ *Id.* art. 5069-1.01-50.06 (Supp. 1967).

¹² TEX. CONST. art. XVI, § 11.

¹³ TEX. REV. CIV. STAT. ANN. art. 5069 § 1(4) (Supp. 1967).

III. ELEMENTS OF USURY AS CONSTRUED BY THE COURTS

The constitutional and statutory provisions relating to usury are hardly self-applying. Consequently, a large body of case law has grown up attempting to define the contours of usury and, particularly, the concept of interest. Judicial analysis of a usury case generally begins with a perfunctory recitation of the court-developed elements of usury. The following are usually listed: (a) an agreement to lend money; (b) the borrower's absolute obligation to repay the loan; (c) the exaction of a greater compensation than allowed by law for the use, forbearance, or detention of money; and (d) an intention to exact usury.¹⁴

Agreement To Lend. One of the few cases in which the requirement of an agreement to lend was instrumental in the decision is *Greever v. Persky*.¹⁵ In *Greever* the original contract, providing for usurious notes, covered a ninety-day term; but the notes were renewed and the borrower continued to pay usurious interest following the expiration of the term. The court held that the interest received during the contract term was usurious. But, stating that one of the necessary elements of usury is a contract to pay usurious interest, the court concluded that the voluntary acceptance of interest in excess of the lawful rate during the period after the original term was not sufficient to constitute usury.

Unquestionably, the borrower paid usury. The lender received the additional usurious interest in consideration for its renewal of the notes and forbearance from collecting the notes when due. The court did not, however, elect to view the case in terms of whether or not usury was paid by the borrower or in terms of the sociological or economic effect of the transaction. Rather, the court appears to have focused on the freedom from "guilt" of the lender—that is, the lender at the outset of the agreement did not contract for or intend to collect usury for the additional term. The court does not even couch the decision in these terms; instead, it clutches the requirement of an agreement to lend as a convenient handle for resolving the case.

Absolute Obligation. The requirement that the borrower be obligated to repay the loan illustrates the historical concern with differentiating between ordinary risk-taking in a business venture and risk-taking incident to a loan. Thus, usury laws are not applicable to a transaction in which repayment depends on the contingency that a well to be drilled will produce a certain quantity of oil;¹⁶ similarly, the question of usury is irrelevant in a transaction which is essentially an investment in a joint venture where the parties pool their resources and hope to earn a profit.¹⁷

¹⁴ See *Campbell v. Oskey*, 239 S.W. 332, 334 (Tex. Civ. App. 1922); 58 TEX. JUR. 2d *Usury* § 8 (1964).

¹⁵ 140 Tex. 64, 165 S.W.2d 709 (1942), which the court remanded for a determination of whether or not there was a contract to collect interest after the stated term.

¹⁶ *Pansy Oil Co. v. Federal Oil Co.*, 91 S.W.2d 453 (Tex. Civ. App. 1936) *error ref.*

¹⁷ *Burton v. Stayner*, 182 S.W. 394 (Tex. Civ. App. 1916) *error ref.* However, if there exists a contingency under which the interest payable may exceed the lawful rate, the agreement may be deemed usurious. See *Shropshire v. Commerce Farm Credit Co.*, 120 Tex. 400, 30 S.W.2d 282 (1930).

Excessive Interest. The judicial requirement that there be an exaction of interest greater than that allowed by law has resulted in a number of ingenious efforts to characterize loan charges as something other than interest. These efforts, and the courts' responses, are reviewed in the next section of this Article.

Intent. Finally, the element of intention to exact usury self-evidently reflects a concern with the "guilt" of the lender, without regard again to the economic or sociological effect of the particular transaction. The element of intent, however, rarely receives a court's admitted attention, particularly when the contract imports usury on its face.¹⁸ If the contract is not usurious on its face, courts have on occasion recited that the borrower must prove "some corrupt agreement, or device or shift to cover usury."¹⁹ However, this recitation seems to be used most often as a postscript, to indicate an orthodox rationale for a decision founded on a strained statutory construction or strictured approach in defining the term "interest."

IV. WHAT CONSTITUTES INTEREST?

The problem of ascertaining what charges imposed by a lender constitute interest has been generative of most of the usury litigation. On its face, the problem would seem appropriately resolved by resort to statutory construction. Indeed, this often is the tack taken by the courts. But interest is not a statutorily defined term.²⁰ Moreover, the judicial efforts to define the term interest cannot be separated from the religious and social policies pertaining to usury. A review of the types of charges incident to loan transactions illustrates the difficulties courts have encountered in attempting to reconcile the policies underlying the usury laws with a construction of the laws themselves.

Computation of Interest. Before reviewing the various charges that may or may not be interest, a word about the method of computing interest is in order. The ten per cent ceiling on interest (other than under the Consumer Credit Code) refers, of course, to simple interest and not to the "add-on" interest rate where interest is charged at the outset and the combined interest and principal are amortized in installments.

The problem of computing the "true" interest rate in the latter situation has led to the development of rules of law concerning the allocation of payments between principal and interest. One such rule is that, where the parties do not agree otherwise, installment payments are applied first to accrued interest and then to principal. The recent case of *Community Sav-*

¹⁸ Kollman v. Hunnicutt, 385 S.W.2d 600 (Tex. Civ. App. 1964) in which, despite the borrower's testimony that there was no usurious intent, the court held that the intent was apparent—*res ipsa loquitur*.

¹⁹ Moser v. John F. Buckner & Sons, 292 S.W.2d 668, 672 (Tex. Civ. App. 1956) *error ref. n.r.e.*

²⁰ "Interest" is generally defined as "a compensation, usually reckoned by a percentage, for the loan, use or forbearance of money." Parks v. Lubbock, 92 Tex. 635, 637, 51 S.W. 322, 323 (1899).

*ings & Loan Ass'n v. Fisher*²¹ illustrates the difficulties encountered in applying this rule. In *Fisher* the loan closing statement specified that the principal amount of the loan was \$7,200 and the rate of interest was five per cent discounted. The borrower executed a note in the amount of \$10,800, payable in 120 monthly installments.

The borrower decided to prepay the note after having made fifty-one payments, a total of \$8,584.93. He calculated that five per cent per annum on \$7,200 for fifty-one months would be \$1,530. He then subtracted the sum paid (\$8,584.93) from the total principal (\$7,200) and the interest computed to date at five per cent (\$1,530) and concluded that he still owed \$145.07 as principal. He tendered this amount, plus the \$75 prepayment charge, to the lender, which the lender refused to accept as full payment.

The court rejected the borrower's claims that either the five per cent figure stated in the closing statement should govern the rate, or, alternatively, if the five per cent figure was not the rate of interest, then no rate had been specified and the lender could charge only six per cent under the statute.²² The court held that the true rate of interest must be ascertained by calculation.

To determine the rate, the court recited the rule that "where parties do not agree otherwise, partial payments on an interest-bearing obligation are ordinarily applied first to accrued interest and the balance to principal."²³ The court stated that the true percentage is that which, "when applied to each monthly balance of principal will, upon crediting the payments in accordance with the rule above stated, result in complete amortization of the \$7,200 principal advance and the \$3,600 interest charge in 120 monthly payments of \$90 each as agreed by the parties."²⁴ Using this method, the court ascertained that the true rate was 8.69 per cent per year. The court concluded that the borrower was "not entitled to have earned interest computed on the balance of the principal remaining unpaid from time to time after the advance payments are credited thereon,"²⁵ the note not being payable "on or before" the stipulated maturity dates.

Such problems in ascertaining the true rate of interest have led to the requirement in the Consumer Credit Code that the number of dollars representing interest be specifically set forth, rather than the "rate" which may be computed by various means.²⁶

Service Charges. Charges for services normally incident to the making of loans, and charges to the borrower for the lender's overhead expenses, will be deemed interest for the purpose of determining usury. Courts take the view that ordinary handling expenses arising in a loan transaction

²¹ 409 S.W.2d 546 (Tex. 1966). See generally Collins, *Evasion and Avoidance of Usury Laws*, 8 LAW & CONTEMP. PROB. 54 (1941).

²² TEX. REV. CIV. STAT. ANN. art. 5070 (1962).

²³ *Community Sav. & Loan Ass'n v. Fisher*, 409 S.W.2d 546, 550 (Tex. 1966).

²⁴ *Id.*

²⁵ *Id.* at 551.

²⁶ TEX. REV. CIV. STAT. ANN. art. 5069-3.15 (Supp. 1967).

should be compensated out of interest, not by means of a separate charge. Accordingly, the following types of charges have been held to be interest: handling charge;²⁷ carrying charge;²⁸ service charge;²⁹ bond issuance expense;³⁰ storage fee;³¹ bookkeeping expense;³² and origination and loan discount fee.³³

On the other hand, it is customary to impose on the borrower, in addition to interest, certain types of charges related to a loan transaction. For example, courts have recognized that charges for separate professional services, such as appraisal and inspection services³⁴ and attorneys' fees,³⁵ are beneficial not solely to the lender and thus have independent significance warranting a separate charge. Some courts, in justifying such fees, have suggested as a test that the fees must be paid to a special agent of the lender with limited authority and that the lender must not participate in the fees.³⁶

Credit Insurance. The case law seems to be settled that premiums on credit insurance required as a condition of making a loan will not be considered interest, as long as the premiums are reasonable in amount and the borrower may select the insurer.³⁷ But if the lender requires the borrower to obtain credit insurance in a company either for which the lender is an agent or from which the lender receives a commission, such premiums will be deemed to be additional interest.³⁸

The problem arose initially out of provisions in the Texas Insurance Code declaring excessive commissions or premiums on credit insurance to be interest.³⁹ The Code has since been amended, however, to provide that the premiums or costs of credit insurance:

²⁷ *Trinity Fire Ins. Co. v. Kerrville Hotel Co.*, 129 Tex. 310, 103 S.W.2d 121 (1937).

²⁸ *Forreston State Bank v. Brooks*, 51 S.W.2d 645 (Tex. Civ. App. 1932).

²⁹ *Thrift Fin. Co. v. State*, 351 S.W.2d 653 (Tex. Civ. App. 1961) *error ref. n.r.e.*

³⁰ *Eastern Mortgage & Sec. Co. v. Collins*, 118 S.W.2d 479 (Tex. Civ. App. 1938) *error ref.*

³¹ *Joy v. Provident Loan Soc'y*, 37 S.W.2d 254 (Tex. Civ. App. 1931) *error dismissed.*

³² *Independent Foods v. Lucas County Sav. Bank*, 46 Ohio L. Abs. 434, 70 N.E.2d 139 (Ct. App. 1946).

³³ *Bankers Guarantee Title & Trust Co. v. Fisher*, 2 Ohio Misc. 18, 204 N.E.2d 103 (C.P. 1964).

³⁴ *Siebert v. Hall*, 63 F.2d 517 (8th Cir. 1933). The Comptroller of the Currency has recently ruled that a national bank may receive an inspection fee on a construction loan in addition to the maximum rate of interest. Lehr, *Current Legal and Regulatory Developments*, 4 THE NAT'L BANKING REV. 111 (1966). The Comptroller has also ruled that "subject to contrary or limiting state statute, a national bank may exact from a borrower in addition to interest taken at the highest rate permitted under state law, reasonable fees or compensation for credit reports or investigations with respect to a borrower's credit." Compt. Rul. 7315 (1966).

³⁵ *James v. Davis*, 150 S.W.2d 326 (Tex. Civ. App. 1941) *error dismissed.*

³⁶ *Nevels v. Harris*, 129 Tex. 190, 102 S.W.2d 1046 (1937). Compare discussion under Brokerage Fees and Commissions, accompanying notes 45-52 *infra*.

³⁷ *Equitable Life Assur. Soc'y v. Kerpel*, 38 Misc. 2d 856, 238 N.Y.S.2d 1016 (Sup. Ct. 1963); *Ware v. Paxton*, 266 S.W.2d 218 (Tex. Civ. App. 1954) *error ref. n.r.e.* But see *Equitable Life Assur. Soc'y v. Scali*, 751 Ill. App. 2d 255, 220 N.E.2d 893 (1966) in which the court held that the premiums received on a life insurance policy required in connection with the mortgage on a house rendered the loan usurious; the court stated that "Equitable was at least as interested in selling life insurance as it was in making the mortgage loan, and that the purpose of requiring [the mortgagor] to buy the policy was not to provide necessary security for the loan, but was, rather, to make a profit on the life insurance in addition to the interest on the loan." 220 N.E.2d at 897.

³⁸ *Ware v. Paxton*, 266 S.W.2d 218 (Tex. Civ. App. 1954) *error ref. n.r.e.*

³⁹ TEX. INS. CODE ANN. art. 3.53, §§ 6, 10 (1963). See, e.g., *Western Guar. Loan Co. v. Dean*, 309 S.W.2d 857 (Tex. Civ. App. 1958) *error ref. n.r.e.*; *Ware v. Wright*, 266 S.W.2d 188 (Tex. Civ. App. 1954); *Hatridge v. Home Life & Accident Ins. Co.*, 246 S.W.2d 666 (Tex. Civ. App. 1951).

[S]hall not be deemed interest, or charges, or consideration, or an amount in excess of permitted charges in connection with the loan or other credit transaction, and any benefit or return or other gain or advantage to the creditor arising out of the sale or provision of such insurance shall not be deemed a violation of any law, general or special, of the State of Texas.⁴⁰

The Insurance Code also provides that, when credit insurance is required as additional security for any indebtedness, the borrower shall, "upon request to the creditor," have the option to place the coverage through any insurer authorized to transact an insurance business within Texas.⁴¹ Giving the borrower the theoretical right to choose his insurer is a rather bland palliative since the commercial practice is for the lender to have (as a matter of convenience to the borrower, of course) credit insurance forms for a particular insurance company available for use by the borrower. And these forms are apparently used in most cases.

The Code provision quoted above is on its face broad enough to eliminate entirely the question of whether or not charges for credit insurance may be deemed to be interest. In the event, however, that a court should determine that a lender's charges for credit insurance were, in fact, a guise for usury or that the lender was receiving additional consideration for placing the credit insurance, it is doubtful that these provisions could withstand an attack under the usury provision of the Texas Constitution.⁴² A similar problem may soon be presented under the retail installment sales provisions of the Consumer Credit Code,⁴³ because many large retailers maintain their own or affiliated credit insurance companies for writing the insurance required for their retail credit installment sales.

Lenders, of course, stress that the purpose of credit insurance is to serve as additional security for the lender or the seller-lender. In this sense, the premiums (which create a fund that eventually may be applied to the loan) resemble other devices, such as investment certificates,⁴⁴ which have been characterized as ruses to collect additional interest. One obvious distinction is that collection of the proceeds is contingent. However, if the lender also collects portions of the premiums (whether as commissions or otherwise) he is receiving an additional yield from the use of money unrelated to the security.

Thus, the legislature has apparently resolved the conflict between the insurance-lending industry and the borrowing public by refusing to consider any of the traditional policies relating to usury: either the borrower has been ignored or a judgment has been made that access to credit is of greater benefit than the detriment involved in paying additional amounts for the use of money.

Brokerage Fees and Commissions. A commission or brokerage fee paid to

⁴⁰ TEX. INS. CODE ANN. art. 3.53, § 9 (Supp. 1967). See generally Davis, *Does the Texas Credit Insurance Act "Legalize" Usury?*, 11 Sw. L.J. 139 (1957).

⁴¹ TEX. INS. CODE ANN. art. 3.53, § 11 (Supp. 1967).

⁴² A similar statute in Arkansas was held to violate that state's constitutional provision against usury. *Stricker v. State Auto Fin. Co.*, 220 Ark. 565, 249 S.W.2d 307 (1952).

⁴³ TEX. REV. CIV. STAT. ANN. art. 5069-6.04 (Supp. 1967).

⁴⁴ See, e.g., *Community Fin. & Thrift Corp. v. State*, 161 Tex. 619, 343 S.W.2d 232 (1961).

the agent or broker of the borrower (or to an independent broker acting for the borrower in the transaction) for services rendered in connection with a loan transaction will not be considered interest, as long as the broker maintains no regular affiliation with the lender and the lender receives no part of the fee.⁴⁵ Any fees paid the lender, or its agents, for negotiations or other such services related to a loan, however, will be deemed interest.⁴⁶

Several Texas cases illustrate the types of practices that will transform such fees into interest. In *Deming Investment Co. v. Giddens*⁴⁷ the lender loaned the borrower \$13,000, evidenced by a \$12,000 note, plus coupon notes in the amount of the stated interest. The borrower was also required to execute five additional notes, purporting to represent commissions earned by the lender for negotiating the loan. The "commission" charges were justified by the lender on the ground that, in the loan application, the borrower appointed the lender its agent to procure the loan. The court stated that:

It is immaterial how or in what manner or form the lender of money cloaks a usurious charge for its use or detention. If the result is that such lender, by such means, exacts more than the maximum rate of interest, the contract is vitiated with the taint of usury. The lender may style the excessive interest a bonus or commission given to him as agent, but if he is in fact the lender of the money, and hence acting for himself and not for another, and receives the bonus or commission for the lending of his own money, the law denominates such 'bonus' or 'commission' as 'additional interest.'⁴⁸

In *Donoghue v. State*⁴⁹ a loan company arranged with a bank to obtain funds to conduct a small loan business. The bank entered into an agreement with the loan company under which the bank supplied all the necessary loan forms; the completed loan applications, together with the supporting notes and chattel mortgages, were transmitted daily to the bank for approval. The bank also guaranteed the loan company's drafts and purchased its discount paper. The loan company charged usurious interest. In a suit against the loan company and the bank, both were held liable. The court concluded that the bank was not merely acting in a brokerage capacity; since the contract allowed the bank to supervise closely the operations of the loan company, the business was, in effect, a joint venture between the two and the bank also was deemed to have charged usurious interest.

In *Greever v. Persky*⁵⁰ the borrower contacted the defendant and offered him a commission to procure a loan. The defendant borrowed the money from a third party, giving his own notes, and in turn advanced the money to the borrower, who executed notes therefor. In holding the commission to be interest, the court stated:

⁴⁵ *Dewey v. American Nat'l Bank*, 382 S.W.2d 524 (Tex. Civ. App. 1964) *error ref. n.r.e.*; *Graham & Locke Invs., Inc. v. Madison*, 295 S.W.2d 234 (Tex. Civ. App. 1956) *error ref. n.r.e.*; *Great S. Life Ins. Co. v. Williams*, 135 S.W.2d 241 (Tex. Civ. App. 1939) *error dismissed*.

⁴⁶ *Deming Inv. Co. v. Giddens*, 41 S.W.2d 260 (Tex. Civ. App. 1931) *error dismissed*.

⁴⁷ *Id.*

⁴⁸ *Id.* at 262.

⁴⁹ 211 S.W.2d 623 (Tex. Civ. App. 1948) *error ref. n.r.e.*

⁵⁰ 140 Tex. 64, 165 S.W.2d 709 (1942).

An agent or a broker may lawfully charge a commission for his services in negotiating a loan with a third party, and such commission will not be taken into consideration in determining whether or not the loan is usurious, where it is done in good faith and not as a mere cloak to avoid the usury law. But, in order to be valid, it must appear that the loan was ultimately made with or passed on to a third party, and that the extra charge was made in good faith for so negotiating the loan. Such a charge may not be made where the party charging the commission is merely lending his own money In this case the party charging the commission did not negotiate the loan to a third party, but made it himself out of his own funds; and, as a consequence, the commission charged and collected by him must be included as interest charged for the use of money lent.⁵¹

But in *Noel v. Panhandle Building & Loan Ass'n*⁵² an insurance salesman solicited prospective borrowers. The applications for loans were filled out and forwarded to the lender for approval. If approved, the lender returned the papers to the insurance salesman who then had the instruments executed and recorded. The borrower was required to pay the insurance salesman a two per cent commission, no part of which was received by the lender. The court held that the commission did not constitute interest.

As is implied in the quoted extracts from these cases, the courts have tended to focus on the "guilt" of the lender, rather than on the economic effect on the borrower. If the lender receives the commission, it will be deemed interest; if an independent loan broker receives the commission, it will not be deemed interest. Thus, in a context of tight money and rising interest rates, the use of independent loan brokers has been hailed as a relief to lenders (particularly large institutional lenders) who otherwise would have to absorb the cost of procuring or servicing loans.

Prepayment Penalty. An additional fee charged for prepayment of the loan is not considered interest.⁵³ Courts have recited varying reasons for this result: that the contingency of prepayment is within the borrower's control;⁵⁴ or that the charge is considered to be made for a new and separate agreement, *i.e.*, the termination of the indebtedness which would otherwise continue.⁵⁵ This treatment has been justified on the ground that the lender has already committed itself to make available certain funds to be advanced in the future or has projected its earnings or loan planning based on its outstanding loans for the terms contemplated. The lender may very well receive usurious interest for the term the indebtedness is actually outstanding. And there is an agreement to pay usury in the event this contingency occurs. By stressing that the contingency is within the control of the borrower, the courts seem to be implying that the lender has not *intended* to exact usury, and therefore is not sufficiently "guilty" to warrant the imposition of the penalties incident to usurious transactions.

⁵¹ *Id.* at 67, 165 S.W.2d at 711.

⁵² 85 S.W.2d 773 (Tex. Civ. App. 1935).

⁵³ See generally T. PATON, *DIGEST OF LEGAL OPINIONS* § 18, at 1 (Supp. 1960).

⁵⁴ *Abbott v. Stevens*, 133 Colo. App. 2d 242, 284 P.2d 159 (1955).

⁵⁵ *Feldman v. King's Highway Sav. Bank*, 278 App. Div. 589, 102 N.Y.S.2d 306 (1951), *aff'd*, 102 N.E.2d 835 (1951); *Reichwein v. Kirshenbaum*, 201 A.2d 918 (R.I. 1964).

Acceleration Clauses. Acceleration clauses are another example of a contingency within the borrower's control—acceleration is normally permitted only if the borrower fails to do something he has promised to do. However, the courts have treated acceleration clauses differently from prepayment clauses.

The general rule emerging from the Texas case law appears to be that a clause permitting acceleration of principal and earned interest will not render the transaction usurious.⁵⁶ But if the holder of the note may accelerate payments including unearned interest, and such interest would exceed ten per cent, the note will be deemed usurious in its inception since it provides for a contingency under which more than ten per cent interest could be collected.⁵⁷

The leading case covering acceleration clauses is *Shropshire v. Commerce Farm Credit Co.*,⁵⁸ in which the deed of trust securing the note provided that, upon default, all the notes should become due at the holder's option. Since the deed of trust further prohibited abatement of unearned interest, the court concluded that the contract stipulated for usurious interest. The court continued:

By the stipulations of the contract, the term of the loan, at the creditor's option, does not extend beyond the date of default in discharging any installment of interest. For the reduced term, which must now be looked to in determining the question of how much interest was promised or paid, the debtors promised and actually paid interest at a rate greater than 10 per cent per annum.⁵⁹

In *Commerce Trust Co. v. Best*⁶⁰ the court of civil appeals stressed that usury:

[D]oes not depend on the question whether the lender actually gets more than the legal rate of interest or not; but on whether there was a purpose in his mind to make more than legal interest for the use of money, and whether, by the terms of the transaction, and the means used to effect the loan, he may by its enforcement be enabled to get more than the legal rate.⁶¹

In the subsequent case of *Marble Savings Bank v. Davis*⁶² the note contained an acceleration clause providing that upon default the "whole indebtedness may . . . be declared due and payable." The court construed this language to refer only to principal and accrued interest; the note was thus salvaged from usury. It thus appears that, if the note or supporting instruments do not expressly provide for the recovery of unearned interest, an acceleration clause will not render the transaction usurious.

⁵⁶ *Sinclair v. Mack Trucks, Inc.*, 355 S.W.2d 563 (Tex. Civ. App. 1962) *error ref. n.r.e.*

⁵⁷ *Clements v. Williams*, 136 Tex. 91, 147 S.W.2d 769 (1941).

⁵⁸ 120 Tex. 400, 39 S.W.2d 11 (1931). *See also* *National Bond & Mortgage Corp. v. Mahanay*, 124 Tex. 544, 80 S.W.2d 947 (1935) (bonds "with interest and all indebtedness and charges secured thereby"); *Dallas Trust & Sav. Bank v. Brashear*, 65 S.W.2d 288 (Tex. Comm'n App. 1934) (notes and "all interest thereon to the date of payment thereof").

⁵⁹ *Shropshire v. Commerce Farm Credit Co.*, 120 Tex. 400, 403, 39 S.W.2d 11, 14 (1931).

⁶⁰ 54 S.W.2d 1037 (Tex. Civ. App. 1932), *aff'd*, 124 Tex. 583, 80 S.W.2d 942 (1935).

⁶¹ 54 S.W.2d at 1039.

⁶² 124 Tex. 560, 80 S.W.2d 298 (1935). *See also* *Mid-State Homes, Inc. v. Knight*, 237 Ark. 802, 376 S.W.2d 556 (1964), in which the court held that an acceleration clause would not permit the creditor to recover unearned interest.

In such cases the courts have reverted to the position of viewing the transaction solely from the lender's standpoint. In this connection, it has been held that the inclusion of a savings clause will cure the usury infection. The courts have indicated that such a clause demonstrates that the lender does not intend to collect usurious interest.⁶³ The exaltation of the savings clause in such a case obviously conflicts with the general rule that actual intent is irrelevant, since intent is presumed when a contract is usurious on its face.

Taxes. A flurry of cases has concerned provisions in loan transactions specifying that the debtor must pay any taxes and other assessments on the note, or deed of trust, or on property serving as security. In *Kansas City Life Insurance Co. v. Duvall*⁶⁴ the deed of trust required the borrower to pay any tax assessments on the bonds involved in the case, if the bonds were the property of a non-resident. In holding that such a provision rendered the contract potentially usurious, the Texas Supreme Court stated:

The happening of the contingency here under consideration depends upon nothing more remote than that a nonresident assignee may establish for the bonds a tax situs in this state. That such a contingency might happen can hardly be said to be so remote as not to have been contemplated by the parties when the contract was made. It is not dependent for its happening upon new legislation or a change in the law that might be made in the future. Its happening was a present possibility of such moment at the time the contract was made that the tax provision was incorporated therein.⁶⁵

In subsequent cases, however, the requirement for showing the potential usury was stiffened. In *Robertson v. Connecticut General Life Insurance Co.*,⁶⁶ for example, the court stated that:

In order to show that it contained potentialities which would make it usurious, certainly it was incumbent on debtors to prove facts showing that under its terms the interest rate, by reason of tax levies, would at some time during the contractual life of the bond exceed 10 per cent. Without laying down any definite rule in this respect, we will say that, in our opinion, the burden would be upon the debtors to prove that under prevailing standards of valuation fixed from year to year, and under prevailing rate or rates fixed from year to year, the taxes which might be levied against the bond would cause the amount exacted to exceed the legal rate of 10 per cent per annum upon the amount of the bond unpaid.⁶⁷

Concern with the remoteness of the contingency in these cases suggests that what is paramount is the lender's intent and not the actual receipt of usurious interest. If the prospect that the contingency will occur is remote (which is determined by allocating the burden of proof), then it likely was not intended by the parties.

⁶³ *Walker v. Temple Trust Co.*, 124 Tex. 575, 80 S.W.2d 935 (1935).

⁶⁴ 129 Tex. 287, 104 S.W.2d 11 (1937). See also *Travelers Ins. Co. v. Rowley*, 133 Tex. 372, 128 S.W.2d 20 (1939).

⁶⁵ *Kansas City Life Ins. Co. v. Duvall*, 129 Tex. 287, 288, 104 S.W.2d 11, 12 (1937).

⁶⁶ 134 Tex. 588, 137 S.W.2d 760 (1940).

⁶⁷ *Id.* at 592, 137 S.W.2d at 765. See also *Texas Land & Mortgage Co. v. Mullican*, 132 F.2d 241 (5th Cir. 1942), *cert. denied*, 319 U.S. 748 (1943); *John Hancock Mut. Life Ins. Co. v. Davis*, 163 S.W.2d 433 (Tex. Civ. App. 1942) *error ref. w.o.m.*

Again, a savings clause generally will avert a determination of usury since it manifests an intent to avoid the collection of usurious interest.⁶⁸ However, the courts have not been consistent here with their approach in the acceleration cases. In cases concerned with the payment of taxes a savings clause will not redeem a transaction otherwise usurious on its face. In *Temple Trust Co. v. Sewell*,⁶⁹ for example, the deed of trust securing the note contained a savings clause to the effect that, if the taxes and interest on the bond exceeded ten per cent, the grantor was not responsible for the excess. The court held this clause ineffective since the bond on its face provided for usurious interest.

Charges After Maturity. A provision in the loan agreement requiring the payment of interest on matured, unpaid installments of interest is permissible, the theory being that after maturity the overdue interest becomes a separate demand on which interest may be charged and, further, the incurrence of the charge may be prevented by the borrower.⁷⁰ Similarly, a provision for attorneys' fees or other fees incident to collection after default will not be deemed a charge of additional interest.⁷¹

Discounting Commercial Paper. The discounting of commercial paper by a national bank is treated as a loan from the purchaser to the seller, regardless of whether the paper has been endorsed "with recourse"⁷² or has been transferred without (or with more restrictive) endorsements.⁷³ Consequently, if such discount exceeds the statutory rate of interest, the discount will be deemed usurious interest.

As to persons other than national banks, the sale of a third party's note at a discount is not regarded as a loan by the purchaser of the note to the seller.⁷⁴ Commercial paper usurious on its face, however, continues to be usurious in the hands of a lender who subsequently purchases the paper.⁷⁵

Similarly, the courts have consistently held that the assignment of conditional sales contracts to a lending institution is not a loan. This financing technique is illustrated in the recent case of *A.B. Lewis Co. v. National Inv. Corp.*,⁷⁶ involving conditional sales contracts covering cars: If a conditional sales contract provided for a principal amount of \$1,000 payable by the buyer of the car within one year from its date, there would be deducted from the car dealer's proceeds upon assignment (with recourse) the amount of \$60 representing the "discount" and \$250 representing the "reserve" (which reserve would not be repaid until the buyer had paid the entire principal amount of his contract).

⁶⁸ *Walker v. Temple Trust Co.*, 124 Tex. 575, 80 S.W.2d 935 (1935).

⁶⁹ 133 Tex. 417, 126 S.W.2d 943 (1939).

⁷⁰ *Mutual Life Ins. Co. v. Fisher*, 165 So. 2d 182 (Fla. App. 1964); *Wichita Falls Bldg. & Loan Ass'n v. Moss*, 82 S.W.2d 171 (Tex. Civ. App. 1935) *error dismissed*.

⁷¹ *Sinclair v. Mack Trucks, Inc.*, 355 S.W.2d 563 (Tex. Civ. App. 1962) *error ref. n.r.e.*

⁷² 12 U.S.C. §§ 85, 86 (1945); *National Bank v. Johnson*, 104 U.S. 271 (1881).

⁷³ *Danforth v. National Bank*, 48 F. 271 (3d Cir. 1891).

⁷⁴ *Lubbock Hotel Co. v. Guaranty Bank & Trust Co.*, 77 F.2d 152 (5th Cir. 1935); *Walker v. Glenn*, 82 S.W.2d 766 (Tex. Civ. App. 1935) *error ref.*

⁷⁵ *Gilder v. Hearne*, 78 Tex. 551, 14 S.W. 1031 (1890); *Lydick v. Stamps*, 316 S.W.2d 107 (Tex. Civ. App. 1958) *error ref. n.r.e.*

⁷⁶ 421 S.W.2d 723 (Tex. Civ. App. 1967).

If deemed a loan, the transaction would have been clearly usurious. Despite the following facts—(1) the buyer was not notified of the assignment and continued making his payment to the car dealer, (2) the dealer remained liable for the full amount of the contract, (3) the lender did not cause the lien on the car to be placed in its name, (4) the dealer could repossess the car in the event of a default, (5) the “reserve” withheld by the lender served as additional security for the payment of the contract, and (6) the car dealer testified that the transaction was referred to as a loan secured by a pledge of the conditional sales contract—the court refused to characterize the transaction as a loan. The court admitted that these facts were consistent with a loan, but remarked that they were not inconsistent with a sale. Although reciting that it would look through the form of the transaction to its substance, the court stressed that the contract documents purported to be an “unconditional sale” and that the lender on occasion rejected certain contracts as poor risks.

Reservation of Interest in Advance and Commitment Fees. As a general proposition, a lender may deduct the interest for a year or less in advance, assuming, of course, that the stated interest rate does not exceed the statutory rate. At the time of receipt, the interest clearly is usurious. Cognizant of this effect, the Texas Supreme Court in *Bothwell v. Farmers' & Merchants' State Bank*⁷⁷ characterized the rule as “difficult to sustain in reason” and “not entirely defensible on principle” and remarked that “most text-writers and many judicial opinions have pointed out how devoid of logic is the rule which sanctions the collection in advance of interest at the highest conventional statutory rate, on even short-term loans, under statutes against usury.”⁷⁸ The court concluded, however, that “in Texas the rule sanctioning the reservation of interest in advance at the highest conventional rate for a year or less is too firmly established to be departed from.”⁷⁹

On the other hand, if the loan agreement provides for usurious interest during the first few years of the term of the loan, even though the total interest exacted over the entire term is within the statutory rate, the agreement will be deemed usurious.⁸⁰ As one example, if the loan agreement required a two and one-half per cent initial fee, plus interest at eight per cent per year, both of which were payable during the first year of the loan, the loan would be usurious even though it covered a longer term during which the entire two and one-half per cent could be absorbed and the average annual interest rate would be less than ten per cent.

There is some authority, however, for the proposition that if the initial fee is deemed to be a commitment fee, the charge would not be considered

⁷⁷ 120 Tex. 1, 30 S.W.2d 289 (1930). See also *McCarthy v. First Nat'l Bank*, 223 U.S. 493 (1912); *North Tex. Bldg. & Loan Ass'n v. Moore*, 82 S.W.2d 397 (Tex. Civ. App. 1935) error dismissed.

⁷⁸ *Bothwell v. Farmers' & Merchants' State Bank*, 120 Tex. 1, 2, 30 S.W.2d 289, 290 (1930). See *First Nat'l Bank v. Davis*, 108 Ill. 633 (1884), in which the Illinois Supreme Court held such a practice to be usurious.

⁷⁹ *Bothwell v. Farmers' & Merchants' State Bank*, 120 Tex. 1, 2, 30 S.W.2d 289, 290 (1930).

⁸⁰ *Dallas Trust & Sav. Bank v. Brashear*, 65 S.W.2d 288 (Tex. Comm'n App. 1933).

interest but rather a charge for an option.⁸¹ Commitment fees, of course, are commonly required, particularly in long-term real estate transactions; and, such fees do, in fact, have at least one characteristic of an option—if the loan is not closed, the commitment fee is forfeited.

The accrual of interest before advances actually are made, at least according to one non-Texas case, will not necessarily render the transaction usurious since the funds have already been set aside for the borrower's benefit though they have not been disbursed.⁸²

V. REMEDIES

As noted above, the Texas usury statutes are designed chiefly to implement the usury provision of the Texas Constitution by setting forth specific remedies. The remedies for charging excessive interest vary, depending in part upon the nature of the lender.

National Banks. The remedies for usurious interest charged by national banks are exclusively those set forth in federal statutes.⁸³ National banks that "knowingly" charge or receive usurious interest on any loan or discount suffer forfeiture of the entire interest on the indebtedness.⁸⁴ In the event usurious interest has been paid, the borrower "in an action in the nature of an action of debt" may recover "twice the amount of the interest thus paid from the association taking or receiving the same."⁸⁵ Thus, in an action by a national bank to recover on the indebtedness, the borrower may neither set off nor apply against principal any usurious interest he may have paid.⁸⁶ The borrower's sole remedy lies in an original action for debt to recover the penalty.⁸⁷ It has been held, however, that the right to recover the statutory penalty may be assigned.⁸⁸

Licensees Under the Consumer Credit Code. The remedies for usury are considerably more harsh with respect to licensees under the Consumer Credit Code, than they were under its predecessor, the Regulatory Loan Act. The penalties under article 1.06 of the Code include: (1) forfeiture of twice the amount of interest contracted for, charged, or received, where

⁸¹ *Pivot City Realty Co. v. State Sav. & Trust Co.*, 88 Ind. App. 222, 162 N.E. 27 (1928). See also *Paley v. Barton Sav. & Loan Ass'n*, 82 N.J. 75, 196 A.2d 682 (1964).

⁸² *Bishop v. Blair*, 90 Ill. App. 64 (1900), in which advances to be made as construction progressed were delayed some six months between the time the notes were executed and the time of the first advance.

⁸³ See, e.g., *Moss v. First Nat'l Bank*, 251 Ky. 390, 65 S.W.2d 88 (1933). See generally *Morris, The Laws of Usury as Applied to National Banks*, 10 BANKING L.J. 847 (1964).

⁸⁴ 12 U.S.C. § 86 (1945).

⁸⁵ *Id.*

⁸⁶ *McCullum v. Hamilton Nat'l Bank*, 303 U.S. 568 (1938); *Rushing v. Citizens' Nat'l Bank*, 162 S.W. 460 (Tex. Civ. App. 1914) error ref. *Contra*, *John R. Alley & Co. v. Federal Nat'l Bank*, 124 F.2d 995 (10th Cir. 1942), in which the Tenth Circuit concluded that the Federal Rules of Civil Procedure permitted a counterclaim.

⁸⁷ *Bothwell v. Farmers' & Merchants' State Bank & Trust Co.*, 125 Tex. 488, 84 S.W.2d 229 (1935). *Contra*, *Robertson v. Burnett*, 172 Neb. 385, 109 N.W.2d 716 (1961), in which the court applied against a national bank a state statute making the entire loan void from its inception.

⁸⁸ *Lasater v. Jacksboro First Nat'l Bank*, 96 Tex. 345, 72 S.W. 1057 (1903), *rev'd on other grounds*, 196 U.S. 115 (1905); *Taylor v. Sturgis*, 68 S.W. 538 (Tex. Civ. App. 1902).

the interest is excessive but not double the amount permitted; and (2) forfeiture of all principal, as well as interest and all other charges, in the event double the amount of interest allowed by the Code is contracted for, charged, or received. In both instances the plaintiff may recover his attorneys' fees; and in the latter instance (charging double the permitted rate) the lender is guilty of a misdemeanor punishable by a fine of not more than \$1,000.⁸⁹

Interestingly enough, if a violation under subsection (1) above results from an "accidental and bona fide error," then there is no penalty attached. In contrast with the focus contained in the preface to the Consumer Credit Code quoted above, this provision seems to evidence a concern with the intent of the lender.⁹⁰

Other Lenders. Article 5069 declares that "all contracts for usury are contrary to public policy and shall be void."⁹¹ However, written contracts providing for usury are void only to the extent of the interest.⁹² Apparently only in the case of usury charged in an oral contract will the entire contract be invalidated.

Also, suit may be brought under article 5073 for the recovery of double the interest paid.⁹³ Thus, the choice of remedy depends on whether or not the interest has been paid. If the usurious interest has not been paid, it need not be; if the usurious interest has been paid, the borrower may recover double the amount of total interest paid.⁹⁴

An additional remedy is furnished in article 4646b⁹⁵ which provides that the district or county attorney or the attorney general may seek a civil injunction against any person, firm, or corporation that habitually loans money at usurious rates.

This array of legislatively created civil and criminal remedies, coupled with the constitutional mandate, bespeaks a strong public policy condemning the practice of charging usury. The tone of the statutes is largely penal and retributive. Moreover, the legislature has attempted to incorporate a consideration of the intent of the lender in determining the degree of penalties.

The Texas courts have accepted the notion that these remedies are penal. From this starting point, the courts have increased the burden of proof re-

⁸⁹ TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Supp. 1967).

⁹⁰ TEX. REV. CIV. STAT. ANN. art. 5069-1.06(1) (Supp. 1967); see text accompanying note 13 *supra*.

⁹¹ TEX. REV. CIV. STAT. ANN. art. 5069-1.02 (Supp. 1967). The remedies enacted by the state legislature are exclusive, and may not be supplemented by city ordinances, *Berry v. City of Fort Worth*, 132 Tex. 599, 124 S.W.2d 842 (1939), or by the courts' exercise of equity powers, *Ex parte Hughes*, 133 Tex. 505, 129 S.W.2d 270 (1939).

⁹² TEX. REV. CIV. STAT. ANN. art. 5071 (1962).

⁹³ *Id.* art. 5073 (1962).

⁹⁴ It should be noted, however, that an usurious contract may be purged and the penalties avoided. This may be accomplished only by cancelling the usurious agreement, *Bookhout v. McGeorge*, 65 S.W.2d 512 (Tex. Civ. App. 1933) *error dismissed*, or by substituting a new agreement founded upon independent consideration that will be equal to the usurious interest, *Bomar v. Smith*, 195 S.W. 964 (Tex. Civ. App. 1917). If the subsequent contract merely results in re-arranging the usurious interest, however, the taint of usury survives, *Commerce Trust Co. v. Ramp*, 135 Tex. 84, 138 S.W.2d 531 (1940).

⁹⁵ TEX. REV. CIV. STAT. ANN. art. 4646b (1962).

quired to show violations and have followed a pattern of strict construction. In *Commerce Trust Co. v. Best*,⁹⁶ for example, the court stated that:

This statute imposes a penalty and therefore is to be strictly construed, at least in the sense that it is not to be extended beyond the necessities of the case and is not to be so broadened as to include persons or things outside its immediate scope and object. . . . This statute was intended to penalize one who exacts and receives the benefit of usury, not every one who may be connected with its collection.⁹⁷

The rule of strict construction followed by the courts is difficult to harmonize with the strong public policy in the Texas Constitution and statutes disapproving the exaction of usury. The public policy is announced and implemented in the strongest terms possible in order to penalize existing violations and to deter prospective violators. The rule of strict construction, however, has served in many cases to frustrate the public policy and to sanction creative devices that conflict with legislative attempts to check credit abuses.

Despite their penal tone, the statutes would seem to be better approached by comparing them to other civil remedies. The remedies for usury are, in the main, consistent with other civil remedies and where more severe are designed as deterrents to abuses that are thought by the legislature to be commensurately more severe in their adverse effect on society. The uncollectibility of usurious interest not paid is comparable to the unenforceability of an illegal contract or other contract contrary to public policy; enforcing a usurious contract to the extent of principal in such a context is hardly penal. Similarly, double recovery allowed for interest paid seems justified in allowing the borrower to recover interest (and other damages) on an amount of money he was unlawfully required to pay; the double recovery may thus be viewed merely as the measure of damages in lieu of a complex factual determination of actual damages, much as is the case with regard to treble damages in civil antitrust cases. Nevertheless, to the extent these remedies are so strictly applied as to devitalize the force of the constitutional mandate, usurious practices can hardly be expected to be discouraged.

VI. NON-USURIOUS TRANSACTIONS AND THE FORM-SUBSTANCE DOCTRINE

The courts seem to be particularly inclined, in usury cases, to say that they will exalt substance over form. But, despite what courts may say in allegiance to the form-substance doctrine, the fact remains that the form of a financial transaction is of critical importance.

Three-Corner Transactions. A recent Texas Supreme Court decision aptly demonstrates the success of a cleverly contrived three-corner transaction, the effect of which is to avoid the application of the usury laws.

⁹⁶ 124 Tex. 583, 80 S.W.2d 942 (1935).

⁹⁷ *Id.* at 591, 80 S.W.2d at 946-47.

In *Stacks v. East Dallas Clinic*⁹⁸ the borrower was indebted to East Dallas Clinic in the total amount of \$652.90. The Dallas Retail Credit Managers Association, together with the Republic National Bank, had arranged a financing plan with the clinic to enable debtors to pay their bills. The debtor applied to an agent of the Association for a loan in the amount of the debt. Concurrently, the debtor signed a non-interest bearing installment note, payable to the Bank, in the amount of the debt. The application form and note were forwarded by the agent to the Bank. The debtor was then required to pay the clinic an amount equal to ten per cent of the face amount of the note. The clinic then paid this sum to the agent, who in turn paid half of the sum (five per cent interest) to the Bank as interest on the note. The Bank then paid the full face amount of the note (the debt) to the creditor (the clinic-hospital) and collected monthly installments from the debtor. The original arrangement proved to be too onerous for the borrower; consequently, the amount of the installments was re-negotiated, and the borrower was required to pay an additional fee.

The borrower sued under article 5073 to recover "double the amount of such interest from the person, firm or corporation receiving the same"⁹⁹ Although acknowledging that the borrower paid usurious interest, the Texas Supreme Court held that no one received usurious interest. The clinic merely received payment of its account receivable since it transferred the interest to the agent; the agent merely received a brokerage fee (though the fee was characterized as "interest" to the borrower); the bank merely received five per cent interest on its loan. In referring to the clinic, the court stated that "a 'benefit' from the interest refers to a direct benefit from the receipt and retention of the interest itself, and not something so incidental as the collection of an account receivable, admitted due, as in this case."¹⁰⁰ The court then concluded that it would "look through the form to the substance of a transaction; and the substance here bears out defendant's contention that it only collected the interest for another, and received no benefit from such interest itself."¹⁰¹

The four dissenters, looking to the substance of the transaction, found a "well designed plan whereby he [the borrower] could obtain a loan, discharge his hospital and clinic bills, but at a cost to him of more than ten per cent per annum."¹⁰²

Perhaps the most illuminating aspect of the majority opinion is its approach. The court states:

A cause of action to recover double the amount of interest paid is derived from a statute creating a penalty. It is not a suit in tort. Since the statute is one involving penalties, the court in . . . [*Commerce Trust Co. v. Best*] said that the statute would be strictly construed and that "the language of the statute is not to be given a mere literal construction."¹⁰³

⁹⁸ 409 S.W.2d 842 (Tex. 1966).

⁹⁹ TEX. REV. CIV. STAT. ANN. art. 5073 (1962).

¹⁰⁰ *Stacks v. East Dallas Clinic*, 409 S.W.2d 842, 845 (Tex. 1966).

¹⁰¹ *Id.* at 845.

¹⁰² *Id.* at 847.

¹⁰³ *Id.* at 846-47.

The court would have been on firmer ground by basing its decision on a brokerage-services doctrine—that is, by holding that a portion of the interest paid was for the services of a broker in handling the loan, which has traditionally been a permitted practice “safe” from the application of the usury laws.¹⁰⁴

The *Stacks* case is not the first three-cornered transaction to come before the courts.¹⁰⁵ In *Goodman v. Seely*¹⁰⁶ the owner of real property requested the lender to loan a prospective purchaser \$15,000 in connection with a proposed purchase and agreed to pay the lender an additional \$5,000 for making such a loan. In a suit to recover the \$5,000 the court disallowed the defense of usury, stating that the owner was not liable on the purchaser's loan, nor was any of his property pledged to secure its payment. The court continued:

There is no showing that he [owner] would in any way be prejudiced if the loan were not repaid. This is a case where one for purposes of his own agrees to pay a certain sum to induce another to loan money to a third person who knows nothing of the transaction. Ordinarily, a bonus given or paid by a stranger to a contract for loan or forbearance, for his own purposes or reasons sufficient to himself, to induce the making of such contract by the lender, does not affect the contract with usury, particularly where it is without the knowledge or consent of the debtor, the purpose underlying usury statutes, which is the protection of debtors against hardship and oppression, having no relevancy where the only loss or detriment is to a stranger.¹⁰⁷

The result in the *Goodman* case is perhaps justifiable since the loan apparently was made at the landowner's request: the “guilt” of the lender is apparently atoned for by the conduct of the borrowers.

But the proposition that a lender may receive additional consideration from a third party as an inducement to make a loan should be confined to similar instances since a lender with economic leverage could easily avoid the usury laws by arranging for a third party to pay additional consideration, the borrower being responsible for paying the third party. And the courts are beholden to the theory that a third person may charge the borrower a fee for such considerations as endorsing or guaranteeing a loan, and the fee will not be deemed interest;¹⁰⁸ in such cases the borrower, in effect, has paid usury, but the lender has not received it.

A related doctrine, and perhaps the most anomalous, is the notion that, if the lender merely requests, rather than requires, the borrower to spend the proceeds in a certain manner, the transaction will not be rendered usurious. The leading case illustrating this proposition is *Mays v. Pierce*,¹⁰⁹ in which the borrower gave a note and deed of trust for \$11,000; at the request of

¹⁰⁴ See text accompanying notes 45-52 *supra*.

¹⁰⁵ For another recent illustration of a multi-cornered transaction in which no usury was found by the court, see *Richards v. Moody*, 422 S.W.2d 200 (Tex. Civ. App. 1967).

¹⁰⁶ 243 S.W.2d 858 (Tex. Civ. App. 1951) *error ref.*

¹⁰⁷ *Id.* at 859. See also *Armstrong v. American Bank & Trust Co.*, 63 S.W.2d 906 (Tex. Civ. App. 1933), *leave to file motion for assignment of error granted*, 123 Tex. 252, 70 S.W.2d 689 (1934).

¹⁰⁸ *Gilmer v. Woodson*, 332 F.2d 541 (4th Cir. 1964); *Oil City Motor Co. v. C.I.T. Corp.*, 76 F.2d 589 (10th Cir. 1935). See also *Greever v. Persky*, 140 Tex. 64, 165 S.W.2d 709 (1942).

¹⁰⁹ 154 Tex. 487, 281 S.W.2d 79 (1955).

the lender, the borrower gave a college \$1,000 of the proceeds of the loan. The Texas Supreme Court held that the transaction was not usurious because the payment was not required as a condition precedent to making the loan. This result obviously is inconsistent with ordinary commercial practices. Even in *Mays* the borrower doubtlessly thought the payment was a requisite to obtaining the loan since he sued for usury. And it seems rather likely that, in a commercial context, the lender's requests are in fact requirements for or conditions to making the loan.

The Credit Price-Cash Price Principle. Perhaps the most striking example of the form-substance problem is known as the credit price-cash price doctrine. Prior to the enactment of the Consumer Credit Code and contrary to the rule in most states, an installment sale of consumer goods in Texas was not a lending transaction so long as the seller quoted to the purchaser a cash price and a separate credit price.¹¹⁰ But if the seller failed to offer the buyer a choice between a cash price and a time-sale price, the differential was deemed interest and, if in excess of ten per cent of the cash price, was considered usurious.¹¹¹

As might be expected, cases posing this problem sink into a quagmire of conflicting testimony as to what was said at the time of the sale. The doctrine has proved troublesome not only to the courts and to the retail merchant whose salesmen fail to recite the magic language, but also to lending institutions that bought the commercial paper arising from such transactions since, if the sale is deemed to be an usurious loan, the holder of the paper is permitted to collect only the principal.¹¹²

Cognizant of the substance of such transactions,¹¹³ the legislature has, in article 6 of the Consumer Credit Code, regulated the "carrying charges" that may be imposed in connection with retail installment sales and has required the amount of the cash price-time price differential to be stated.¹¹⁴

The Collateral Advantage Doctrine. The general rule is that a collateral transaction between the borrower and lender under which the lender may earn a profit will not render the transaction usurious, if entered into in good faith and without an intent to exact usury. Courts are quick to add, however, that the collateral transaction must not be a guise for obtaining usury, such as one requiring the borrower to purchase property at an exorbitant price or to sell goods to the lender at a discount.¹¹⁵

¹¹⁰ See, e.g., *Lamb v. Ed Maher, Inc.*, 368 S.W.2d 255 (Tex. Civ. App. 1963); *Rattan v. Commercial Credit Co.*, 131 S.W.2d 399 (Tex. Civ. App. 1939) error ref. See generally Koch, *Time Sales Contracts*, 28 TEXAS B.J. 181 (1965); Comment, *Usury Statutes as Applicable to the Sale on Credit*, 31 TEXAS L. REV. 55 (1952). The credit price-cash price doctrine is criticized sharply in Warren, *Regulation of Finance Charges in Retail Installment Sales*, 68 YALE L.J. 839, 843 (1955).

¹¹¹ See, e.g., *Bradford v. Mack*, 359 S.W.2d 936 (Tex. Civ. App. 1962) error ref. n.r.e.; *Associates Inv. Co. v. Baker*, 221 S.W.2d 363 (Tex. Civ. App. 1949) error dismissed.

¹¹² *Clements v. Williams*, 136 Tex. 97, 147 S.W.2d 769 (1941).

¹¹³ TEX. REV. CIV. STAT. ANN. art. 5069-6.02(f)(6) (Supp. 1967).

¹¹⁴ *Hartridge v. Home Life & Accident Ins. Co.*, 246 S.W.2d 666 (Tex. Civ. App. 1951) error dismissed.

¹¹⁵ *C. C. Slaughter Co. v. Eller*, 196 S.W. 704 (Tex. Civ. App. 1917) error ref.; 58 TEX. JUR. 2d Usury § 29 (1964).

Similar problems have arisen challenging the courts to determine the threshold question of whether or not the transaction is a loan or some other form of investment. In *Dante v. Givens*¹¹⁶ the borrower obtained a \$3,000 loan for one and one-half months and agreed to assign the lender a \$6,800 note and a second mortgage; the lender agreed to reassign the mortgage upon repayment of the \$3,000 plus an additional \$600. The court held that this transaction was an usurious loan and not the sale of a mortgage. In *Golden State Lanes v. Fex*,¹¹⁷ a bowling alley, needing \$150,000 for remodeling its leased premises, entered an arrangement whereby a third party advanced the \$150,000 for the purchase of the lease. The premises were then sublet to the bowling alley, and the bowling alley agreed to repurchase the lease at the end of the stated period for a sum of \$150,000. During the term of the sublease, the bowling alley was required to pay additional sums for the sublease. The court held that this transaction was a guise for an usurious loan.

In other cases, the courts have seemed to err on the side of concluding too quickly that a transaction was a loan. In *Glover v. Buchman*¹¹⁸ the borrower was required, in connection with a loan of \$100, to pay \$10 for purchase coupons, having a face value of \$12.50, that could be applied as twenty-five per cent of the purchase price of goods bought from the coupon service company. The court could have pitched its decision on the ground that the borrower was obtaining a quid pro quo for the additional commitment it was required to make and that this was not interest. But the court held that the lender intended to exact usury and noted that "it is unreasonable to expect needy persons, as a rule, to make full use of such a coupon."¹¹⁹ The court was thus concerned with the power of lenders to exact collateral advantages from borrowers as a condition to making the loan. Though the court's concern to penetrate to the substance was salutary, the appropriate method of attacking such practices would seem to be under the antitrust laws.

VII. RECENT STATUTORY ENACTMENTS

The current trend in the legislative approach to charging interest is a continuing, gradual expansion of the scope of permissible charges. Although initially formulated by the courts, the differentiation between cash price and credit price as set forth in the Consumer Credit Code is one example of such expansion.¹²⁰ Another example of expansion, derived from prior legislation and also carried forward in the Consumer Credit Code, is the greater interest rates allowable in the case of small loans.¹²¹

¹¹⁶ 156 So. 2d 13 (Fla. App. 1963). Compare the following Texas cases: *Cotton v. Cooper*, 209 S.W. 135 (Tex. Comm'n App. 1919) (contract to purchase wages); *Ellis v. Security Underground Storage, Inc.*, 329 S.W.2d 313 (Tex. Civ. App. 1959) (yield for advances included interest and rentals; lender tried to characterize the fees either as consideration for his signing, endorsing, and guaranteeing some of borrower's indebtedness or as return from a joint venture).

¹¹⁷ 42 Cal. Rptr. 568, 232 Cal. App. 2d 127 (Dist. Ct. App. 1965).

¹¹⁸ 104 S.W.2d 66 (Tex. Civ. App. 1937) *error dismissed*.

¹¹⁹ *Id.* at 67.

¹²⁰ TEX. REV. CIV. STAT. ANN. art. 5069-6.01-6.09 (Supp. 1967).

¹²¹ *Id.* art. 5069-3.15.

The amendment to the Insurance Code permitting premiums of credit insurance to be deemed charges other than interest is an additional example;¹²² this provision has been carried forward in the Consumer Credit Code by allowing such premiums to be charged in addition to the specified interest rates.¹²³

Another recent illustration is the amendment to the Texas Miscellaneous Corporation Laws Act permitting corporations to pay up to one and one-half per cent per month interest on obligations in the principal amount of \$5,000 or more.¹²⁴ It remains to be seen whether this provision will be deemed to be constitutionally permissible as legislation fixing maximum rates of interest at a greater rate than ten per cent, or whether (to avoid constitutional questions) the statute will be construed as permitting corporations to borrow money at such rates when the rates are permitted in the particular state (other than Texas) in which the loan is made.

All of these recent statutory enactments have in common the expansion of the scope of permissible activity with respect to usury. According to their terms, all appear to be directed at a particular economic and sociological effect upon the society as a whole, or upon some designated part of it, rather than at the culpability of the particular lender.

VIII. A SELECTED CURRENT PROBLEM: COMPENSATING BALANCES

A \$1,000 loan for one year, with interest at eight per cent, and with no other charges of any kind by the lender, is clearly not usurious. But if the lender requires that \$500 of the loan proceeds remain with the lender for the full term of the loan, then an argument can be made that the amount actually loaned is only \$500, and that the effective rate of interest is sixteen per cent. The nub of the inquiry is not the interest rate, which can be readily computed, but how much is effectively loaned.

The question is not an academic one. It has become increasingly common for banks to require, as security for or as a condition of default upon a loan, that the borrower maintain or cause to be maintained with the lending bank a "compensating balance" during the term of the loan. Although the question is unsettled, the practice of requiring compensating balances runs a risk of usury, for a court might hold that the principal of the loan on which interest is calculated consists of the funds advanced to the borrower less the deposits required to be maintained.

Some commentators and courts in other states have concluded that such a practice is usurious.¹²⁵ In *Planters' National Bank v. Wyson & Miles Co.*¹²⁶ a bank loaned \$2,000 but retained \$500 as a deposit of the borrower not subject to check or withdrawal. The court determined that interest should be computed on only \$1,500, which rendered the transaction usurious. This case may be distinguishable from current practices in that the de-

¹²² See text accompanying note 40 *supra*.

¹²³ TEX. REV. CIV. STAT. ANN. art. 5069-3.18 (Supp. 1967).

¹²⁴ *Id.* art. 5069-2.09.

¹²⁵ T. PATON, DIGEST OF LEGAL OPINIONS § 19.3, at 2369 (1942).

¹²⁶ 177 N.C. 431, 99 S.E. 199, *cert. denied*, 250 U.S. 665 (1919).

posit was not subject to withdrawal. Under most loan agreements requiring compensating balances, the deposit, by definition, is subject to the borrower's withdrawal; but the effect of a withdrawal without the consent of the bank is an event of default under the loan agreement.

The court in another case seems to agree, in general, with the result of the *Wysong & Miles* case. In *Hershey v. Anderson*,¹²⁷ following a series of transactions the culmination of which was a note signed by the borrower in the amount of \$20,000, the bank required the borrower to execute an additional note for \$3,500 with interest payable at six per cent. The agreement called for the proceeds of the \$3,500 loan to be used to purchase a non-interest-bearing certificate of deposit, which was pledged as security for the \$3,500 note. The additional note eventually was paid by offsetting the certificate of deposit. The court held that requiring this note was merely a device to collect additional interest from the borrower on the \$20,000 loan.

On the other hand, in *National Bank v. Levine*,¹²⁸ the bank, in addition to reserving a discount equal to the maximum interest rate, required the borrower to make monthly deposits to the credit of a compound interest account; the account was then assigned to the bank as security for the loan. The court refused to regard the required deposits as diminutions of principal for purposes of determining the amount of interest paid.

No Texas case has squarely presented the question of the treatment to be accorded to compensating balances. The recent case of *Flurry v. Hillcrest State Bank*¹²⁹ is, however, analogous. The bank loaned the borrower \$17,502 and required him to give a note in the principal sum of \$20,652, the extra \$3,150 representing interest on the note for thirty-six months. The borrower was then required to open an account with the bank, agreeing to pay certain consecutive monthly deposits into the account. In the collateral agreement the borrower assigned the savings account as further security for the note. The note expressly declared that, in the event of default in making such deposits, the balance of the note would become due; further, the collateral agreement provided for the assignment of the borrower's account and passbook and authorized the bank to apply the funds in such account on the note in the event he failed to make any of the deposits. The court conceded that the documents were ambiguous, but held that the deposits to the account were actually payments on the note; the transaction was thereby rendered usurious.

Similarly, in *Citizens Industrial Bank v. Schmidt*¹³⁰ the borrower borrowed \$270, executing a note for \$300 bearing ten per cent interest, and also signed an agreement to purchase an installment certificate for \$300 to be paid out in ten monthly installments of \$30 each, the certificate to yield four per cent interest. The court held that the transaction was usurious and that the installment certificate was only a device to cover the

¹²⁷ 127 F.2d 884 (6th Cir. 1942).

¹²⁸ 277 N.Y.S. 664, 155 Misc. 132 (N.Y.C. Mun. Ct. 1933).

¹²⁹ 401 S.W.2d 857 (Tex. Civ. App. 1966) *error ref. n.r.e.*

¹³⁰ 112 S.W.2d 513 (Tex. Civ. App. 1937) *error ref.*

usurious character of the interest. But the court noted that "if appellant had complied with the law regulating the operation of Morris Plan banks, and had made its contract in conformity with the law, [its] contention might be sustained."¹³¹ The court observed that the borrowers had not been informed that they were purchasing investment certificates, that no certificate had been delivered, and that no credits of interest earned or payments on the investment had been entered on the bank's books. Thus, the court implied that, had the bank actually paid the interest on the certificate and observed the other formalities incident to such a practice, a different result might have been reached.

A related line of cases concerns the investment certificate plan used by small loan companies. Under this plan, the borrower signs an interest-bearing note, the amount of which is due at a certain date. As a condition to obtaining the loan, the borrower is required to subscribe for an investment certificate having a face amount at maturity equal to the face amount of the note and yielding interest at one and one-half per cent. The borrower then makes periodic installment payments under the certificate. The certificate is pledged as security for the loan. At maturity, the borrower may either apply the certificate to offset the loan or may repay the loan with separate funds and convert the certificate into a fully paid certificate earning three per cent interest thereafter.

The Texas courts of appeal divided on the question of whether the payments on the certificates are a separate, independent transaction or merely repayments of the loan, in which event the loan becomes usurious.¹³² In 1961 the Texas Supreme Court sided with the courts condemning such a practice as usurious.¹³³ It should be noted, however, that these lenders never issued such certificates except in connection with a loan. This lack of independent status of the investment may distinguish these cases from a transaction in which a bank requires a certificate of deposit as collateral.

A contrary line of Texas cases involves loans by building and loan associations. As a condition to obtaining the loan, the borrower was required to pay an "admission fee" and subscribe for stock in the association.¹³⁴ In absolving this practice from the taint of usury, the courts stressed that a dual relationship was created: that of borrower and member. Since the savings and loan statute provided that borrowing members would share in losses, as well as in profits, and were permitted to vote at shareholders'

¹³¹ *Id.* at 514.

¹³² *State v. Pacific Fin. Loans*, 337 S.W.2d 525 (Tex. Civ. App. 1960), *aff'd*, 161 Tex. 619, 343 S.W.2d 232 (1961); *State v. Household Fin. Corp.*, 334 S.W.2d 569 (Tex. Civ. App. 1960), *aff'd*, 161 Tex. 619, 343 S.W.2d 232 (1961); *State v. Community Fin. & Thrift Corp.*, 334 S.W.2d 559 (Tex. Civ. App. 1960), *aff'd*, 161 Tex. 619, 343 S.W.2d 232 (1961); *Harrell v. Colonial Fin. Corp.*, 341 S.W.2d 545 (Tex. Civ. App. 1960) *error ref. n.r.e.*—all condemning this practice. *Steiner v. Community Fin. & Thrift Corp.*, 258 S.W.2d 129 (Tex. Civ. App. 1953) *error dismissed by agreement*; *Reams v. Community Fin. & Thrift Corp.*, 236 S.W.2d 185 (Tex. Civ. App. 1951)—both approving this practice. This type of plan was authorized by statute, *TEX. REV. CIV. STAT. ANN.* art. 1524a-1 (1962). The court in *State v. Community Fin. & Thrift Corp.*, *supra*, however, ruled the statute unconstitutional.

¹³³ *Community Fin. & Thrift Corp. v. State*, 161 Tex. 619, 343 S.W.2d 232 (1961).

¹³⁴ *Interstate Bldg. & Loan Ass'n v. Goforth*, 94 Tex. 259, 59 S.W. 871 (1900); *Wood v. Continental Sav. & Bldg. Ass'n*, 56 S.W.2d 641 (Tex. Comm'n App. 1933).

meetings,¹³⁵ a genuine separation of attributes was preserved. One court also stressed the fact that the borrower might receive up to six per cent return on his stock investment.¹³⁶

Assuming the validity of the dual relationship theory, an argument could be constructed in support of the practice of requiring compensating balances or certificates of deposit. A demand deposit or a certificate of deposit creates a debt owed by the bank to the borrower. Either has independent significance, as is demonstrated by the large number of deposits and certificates of deposit that are unrelated to loan transactions. The borrower becomes at once debtor and creditor. Further, the borrower, at least theoretically, is in control of the funds—he may withdraw the demand deposit or cash out the certificate of deposit. The funds are simply further collateral for the loan in a case where the borrower is unable to offer alternative acceptable collateral to the bank. There is no demonstrable intent to exact usury since the borrower will receive all the funds and pay only a legal rate of interest on the principal.

Nevertheless, the practice of requiring compensating balances presents a serious risk of a claim of usury, and courts may well be sympathetic to such a charge. There are several possible procedures that might successfully be used in lieu of expressly requiring compensating balances by a provision in the loan agreement. One is simply to have an understanding that, as a good faith business deal, the borrower would be expected to become a customer of the bank and maintain certain demand deposits with the bank. Nothing is put in writing, and the subject is not discussed specifically as a condition to making the loan. If the borrower fails to maintain the anticipated balances, this would be a factor in considering a renewal or further advances under a line of credit. A second method would be to require or request a borrower to cause a third person to maintain deposit balances with the bank—the third person could be an affiliated company or the like. This practice would at least preserve an argument that the full principal is, in fact, being advanced or made available to the borrower. And under a fundamentalist approach, such as that in the *Stacks* case discussed above,¹³⁷ such a three-corner arrangement likely would shelter the transaction from an attack on the basis of usury. This method, however, might be vulnerable to attack on an agency theory.

As is evident in this discussion, analogies to different lines of cases may lead to different conclusions in an attempt to resolve the compensating balances problem. A recalling of the "past" of usury offers little help in the analysis, for the "guilt" or even the intent of the lender in such cases is hardly discernible and not particularly relevant. What does seem important is a careful analysis of the sociological effect of each particular transaction. The effect varies from case to case, depending on the economic leverage of the lender, the station in society of the borrower (and thus the "risk"), money-market conditions, and the like. The resolution of this question,

¹³⁵ Former art. 881a-34, Tex. Rev. Civ. Stat. Ann. (1964).

¹³⁶ *Interstate Bldg. & Loan Ass'n v. Goforth*, 94 Tex. 259, 59 S.W. 871 (1900).

¹³⁷ See text accompanying notes 98-104 *supra*.

then, will necessarily involve careful consideration of every aspect of the transaction.

IX. CONCLUSION

The preceding discussion of compensating balances is illustrative of the difficulties encountered when approaching an usury question not previously decided by the courts. The religious "past" of usury, while helpful in understanding its development and on occasion accounting for the approach taken in judicial decisions, is not very helpful in solving current problems. Even the economic and sociological "past" of usury is not particularly helpful in the resolution of current issues, for economic and sociological considerations change. In recognition of that fact, the Texas Legislature has followed a pattern, for the past several years, of expanding the limits of charges that are permissible in connection with loans. It has also determined to concentrate its regulation on those lending transactions pertaining to the segments of society that are largely incapable of maintaining an even bargaining position.

One consequence of the emphasis upon the economic and sociological effect of usury is that of viewing lending transactions in the same terms as other investments; that is, the recent legislation tends to set a maximum yield commensurate with the risk involved. Lending transactions are presently regulated, not to preserve any notion of their inherent differences from other investment transactions, but chiefly to curb abusive credit practices with their attendant adverse social implications, much as monopolization and unfair trade practices are regulated for similar purposes.

Courts will continue to be confronted with problems of ascertaining what charges constitute interest and of examining the substance of transactions framed to avoid the application of the usury laws. Courts historically have wavered between the variant approaches to usury questions, on some occasions stressing the "guilt" of the lender, on others stressing the form of transactions, and on others stressing the importance of a strict construction of the usury laws; too often, it would seem, courts have disregarded the substance of the transaction in favor of other approaches.

If the focal point in an usury case is to be its sociological and economic implications, the courts must scrutinize every aspect of the litigated transactions. And since what is considered economically and sociologically important changes from time to time, the courts must be prepared to change the context of their inquiry. This approach means, in essence, a case by case development of guidelines that expand or contract as the economic or sociological considerations vary—an approach similar to that required in determining the "unconscionability" of a sales transaction under article 2-302 of the Uniform Commercial Code.¹³⁸ One of the consequences of this approach will be a lack of certainty as to the applicability of the usury laws to particular types of transactions. But a substantial degree of

¹³⁸ UNIFORM COMMERCIAL CODE § 2-302.

uncertainty already exists, and predictability, while desirable, is not so important that it overrides all the other pertinent considerations.

The end to be achieved is not a logically correct but rigidly doctrinaire statutory construction; rather, what is sought is a balance between curbing abusive lending practices, on the one hand, and allowing an appropriate return for the loan of money on the other. It is this approach, and not an approach based either on "punishment" or upon "strict construction" to avoid punishment, which should form the basis of the public policy in Texas in the field of usury law.